LEGISLATIVE SERVICES AGENCY
OFFICE OF FISCAL AND MANAGEMENT ANALYSIS

200 W. Washington, Suite 301
Indianapolis, IN 46204
(317) 233-0696
http://www.in.gov/legislative

FISCAL IMPACT STATEMENT

LS 7030 | **NOTE PREPARED:** Jan 13, 2004
BILL NUMBER: HB 1305 | **BILL AMENDED:**

SUBJECT: Funding for Certain State Programs.

FIRST AUTHOR: Rep. Day | **BILL STATUS:** As Introduced
FIRST SPONSOR:

FUNDS AFFECTED: X GENERAL
X DEDICATED
FEDERAL

IMPACT: State & Local

Summary of Legislation: The bill imposes graduated individual Adjusted Gross Income Tax rates and increases the state Earned Income Tax Credit to 10% of the federal Earned Income Tax Credit.

The bill establishes the CHOICE Account to provide services under the Community and Home Options to Institutional Care for the Elderly and Disabled Program (CHOICE). Beginning July 1, 2006, the bill provides that an eligible individual shall not have to wait more than 90 days for CHOICE services.

The bill also provides an annual grant to each school corporation that offers a full-day kindergarten program.

The bill repeals: (1) a provision specifying that the Comprehensive Program of Home and Community-Based Long-Term Care services is subject to funding available to the Office of the Secretary of Family and Social Services; and (2) a provision under which the state Earned Income Tax Credit is to expire.

Effective Date: July 1, 2004; January 1, 2005; July 1, 2005; January 1, 2006.

Explanation of State Expenditures: *Full-Day Kindergarten Grants:* Schools that offer full-day kindergarten could receive additional funding for kindergarten students attending full-day kindergarten. Currently, kindergarten students attending full-day or half-day programs are counted as ½ of an ADM for school formula funding purposes. The bill would compute the difference in the funding between counting full-day kindergarten students as ½ and 1 ADM for the regular tuition support formula, growing enrollment formula, at-risk formula, primetime formula, and transportation formula. The impact would depend on future school formulas. Currently, the regular tuition support formula, growing enrollment formula, at-risk formula, and primetime formula are repealed January 1, 2006. The impact would depend on the school formulas enacted by future General Assemblies and the number of schools that would offer full-day kindergarten. The following is the estimated annual impact if all kindergarten students attended full-day programs during the 2005 school year.

Program	Impact
Regular Tuition Support	$83.9 M
Growing Enrollment Grant	44.2 M
At Risk Grant	0
Prime Time Grant	1.2 M
Transportation Grant	1.2 M
Total	$130.5 M

Department of State Revenue (DOR): The Department of State Revenue would incur some administrative expenses relating to the revision of tax forms, instructions, and computer programs to incorporate the new rate structure and the change in the Earned Income Tax Credit (EITC). These expenses presumably could be absorbed given the DOR's existing budget and resources.

Earned Income Tax Credit Refunds: The refundable portion of the Earned Income Tax Credit that goes to participants in the Temporary Assistance to Needy Families (TANF) Program qualifies as maintenance of effort (MOE) expenditures and contributes toward the state's annual MOE requirement under the TANF Program. It is estimated that refunds of the current 6% EITC could potentially total about $8.0 M annually. This is based on a simulation utilizing state taxpayer data and federal Earned Income Credit (EIC) data. The increase in the EITC from 6% to 10% is estimated to increase refunds to approximately $19.0 M annually. However, the amount of refund total that could potentially be claimed by TANF participants is indeterminable.

CHOICE Program: This provision creates the CHOICE account as a nonreverting account within the General Fund beginning July 1, 2006. Money remaining in the account at the end of each state fiscal year is to be annually appropriated for CHOICE administration and services. The money in the account may not be used to provide funds for a Medicaid waiver.

Appropriation and reversion experience within the existing CHOICE account is presented below.

Fiscal Year	CHOICE Appropriation	Medicaid Waiver Transfer from CHOICE	Reversion to the General Fund
FY 2005	$ 48,673,544	$ 5.6 M	NA
FY 2004	$ 48,673,544	$ 5.6 M	NA
FY 2003	$ 48,683,904	$ 5.6 M	$ 5,456,852
FY 2002	$ 48,683,904	$ 5.6 M	$ 2,700,000
FY 2001	$ 42,623,785	$ 4.9 M	0
FY 2000	$ 42,623,785	$ 4.9 M	0
FY 1999	$ 37,482,455	$ 4.9 M	0

The fiscal impact of this provision would be dependent upon administrative decisions made by the State Budget Agency, the Family and Social Services Administration, or the State Board of Finance. The nonreverting status of the account created by this bill does not guarantee that the CHOICE program would be permitted to increase the base level of services provided above the level budgeted and considered sustainable; or that the funds would remain available to the program for expenditure over time. Appropriations must be allotted by the State Budget Agency, the Family and Social Services Administration also may request the State Budget Agency to transfer funds within the Agency, and the State Board of Finance may transfer unused funds to the General Fund or to other agencies.

The bill would require the state to offer home and community-based services on an "on demand" basis to eligible individuals over the age of 65 years. The fiscal impact of this provision will depend upon legislative and administrative actions. Thousands of additional individuals could become eligible for services and potentially the state Medicaid plan benefits. Additional expenditures may result in some cost avoidance realized by delaying or avoiding admissions to nursing facilities. However, the requirement to pay for home services would be immediately effective, while the potential reduction in nursing home costs may not occur simultaneously or in the same amount as the additional cost.

The bill would require funding the CHOICE program in FY 2007 as an open-ended entitlement since the bill requires that services must be provided within 90 days. The Division reported that the CHOICE program had 12,977 individuals on waiting lists throughout the state in November of 2002. Cost of services provided to CHOICE recipients in FY 2001 was reported to be $38.8 M for 12,537 recipients. This provision could require an additional $40 M in state funds, doubling the size of the program. The CHOICE appropriation was $48.7 M for FY 2004 and FY 2005 although $6.3 M and $6.5 M for each year respectively is transferred to the Medicaid program to provide funding for waiver services.

The bill also requires the Area Agencies on Aging (AAAs) to determine the program eligibility for all persons on a waiting list for services by the end of FY 2006. The fiscal impact of this provision is unknown at this time.

Explanation of State Revenues: The net impact from the individual AGI Tax rate changes and changes made to the EITC are presented in the table below.

	FY 2005	FY 2006	FY 2007	FY 2008
Graduated Tax Rates	$285.2 M	$698.1 M	$634.7 M	$426.1 M
Increased EITC	(11.7 M)	(46.8 M)	(74.3 M)	(77.3 M)
Net Impact	$273.5 M	$651.3 M	$560.4 M	$348.8 M

Graduated AGI Tax: The bill replaces the current individual AGI tax rate equal to 3.4% on all taxable income with a graduated tax rate structure beginning in tax year 2005. The graduated tax rate structure imposed in 2005 and 2006 would be phased down in 2007 and 2008, with the 2008 rate structure being permanent. The graduated tax rate structures are presented in the table below.

	AGI Tax Rate		
Taxable Income Range	**2005- 2006**	**2007**	**2008 and after**
Less than $30,000	3.4%	3.4%	3.4%
$30,000 to less than $60,000	4.2%	3.95%	3.7%
$60,000 and above	5.0%	4.5%	4.0%

These graduated tax rate structures are estimated to generate $285.2 M in FY 2005; $698.1 M in FY 2006; $634.7 M in FY 2007; and $426.1 M in FY 2008. The current law distribution percentages for individual AGI Tax to the state General Fund and the Property Tax Replacement Fund are changed by the bill so incremental revenue generated by the tax rate changes is distributed to the state General Fund.

The revenue estimates are based on the average change in tax liability observed in simulations conducted with data from individual income tax records from 1999, 2000, and 2001. The 2005-2006 tax structure is estimated to have a 16.7% increase on base revenue from the existing 3.4% tax. The 2007 and 2008 rate structures are estimated to have 11.5% and 6.3% impacts, respectively, on base revenue from the 3.4% tax. These rates of change are applied to the Revenue Technical Committee's updated (January 12, 2004) FY 2005 forecast of $3,971.8 M. Estimates for subsequent years assume 5.1% annual growth in base revenue (equal to forecast revenue growth from FY 2004 to FY 2005). The impact of the tax year 2005 change is expected to affect FY 2005 revenue due to increased monthly withholdings and quarterly estimated payments during the second half of FY 2005.

Earned Income Tax Credit: The bill would reduce state AGI Tax liabilities of individual taxpayers who qualify for the current EITC beginning in tax year 2005. The revenue impact is expected to begin in FY 2005, assuming the increase in the EITC leads to reductions in monthly withholdings during the second half of the fiscal year. The estimated annual revenue loss from the bill in FY 2005 to FY 2008 is presented in the table below. The estimated revenue loss reflects the additional cost from the 10% EITC over the cost that would otherwise be incurred in accordance with current law. The revenue loss is estimated to increase by 4% per year after FY 2008.

Fiscal Year	Est. Revenue Loss from 10% EITC
2005	$11.7 M
2006	46.8 M
2007	74.3 M
2008	77.3 M

Under current statute, the EITC is equal to 6% of the federal Earned Income Credit (EIC) and is scheduled to sunset after tax year 2005. The bill would increase the EITC from 6% to 10% of the federal EIC beginning in tax year 2005 and eliminate the current sunset provision. It is estimated that the current EITC will cost $41.2 M in FY 2005 and $24.6 M in FY 2006. The estimated revenue loss in FY 2006 is attributable to expected reductions in withholding due to the current EITC during the second half of tax year 2005. As the current EITC sunsets after tax year 2005, there will no longer be a revenue loss beginning in FY 2007. Thus, the estimated revenue loss for FY 2005 and for part of FY 2006 is attributable to the increase in the EITC from 6% to 10% in tax year 2005. The estimated revenue loss for part of FY 2006, and all of FY 2007 and FY 2008, is attributable to the 10% EITC in its entirety beginning in tax year 2006.

Assuming the base cost of the current 6% EITC beyond FY 2005, the budgetary impact of the increase to 10% is between $28 M and $31 M annually in the near term. The estimated base cost of the 6% EITC and resultant budgetary impact for FY 2005 to FY 2008 is presented in the table below.

Fiscal Year	Est. Base Cost of 6% EITC	Budgetary Impact of 10% EITC
2005	$41.2 M	$11.7 M
2006	42.9 M	28.6 M
2007	44.6 M	29.7 M
2008	46.4 M	30.9 M

Federal income tax data for tax year 2001 indicates that the federal EIC was claimed by 373,810 federal income tax filers residing in Indiana. The credits claimed in 2001 totaled about $600.5 M. Annual growth in credits claimed by Indiana filers averaged 3.9% from 1999 to 2001.

Explanation of Local Expenditures:

Explanation of Local Revenues: See *Explanation of State Expenditures.*

State Agencies Affected: Department of State Revenue, Department of Education.

Local Agencies Affected: Local School Corporations.

Information Sources: OFMA Income Tax Database, 1999, 2000,2001. Internal Revenue Services, *Statistics on Income*, http://www.irs.gov/taxstats.

Fiscal Analyst: Jim Landers, 317-232-9869, Chuck Mayfield, 317-232-4825; Kathy Norris, 317-234-1360.